

06641

1 IN THE UNITED STATES DISTRICT COURT
2 FOR THE NORTHERN DISTRICT OF ALABAMA
3 SOUTHERN DIVISION

4 UNITED STATES OF AMERICA,

5 CR-03-BE-530-S

6 v. Birmingham, Alabama

7 RICHARD M. SCRUSHY, March 3, 2005

8
9 Defendant.

10 *****

11
12 TRANSCRIPT OF TRIAL
13 BEFORE THE HONORABLE KARON O. BOWDRE
14 UNITED STATES DISTRICT JUDGE, and jury.

15 VOLUME XXIV

06755

1 of years before to Integrated Health, because we
2 didn't want to be in that business.

3 So I wasn't so sure, and I think even
4 Mr. Scrushy wasn't so sure that that was
5 strategically the best move.

6 MR. LEACH: Objection, Your Honor, to
7 Mr. Scrushy's knowledge.

8 THE COURT: Sustained.

9 A. I'm sorry. At any rate, it was -- I did
10 not believe it was a strategic move for the
11 company, a good strategic move for the company.

12 So, I enlisted Bill McGahan, who was
13 our investment banker at that time, to assist me
14 in talking Mr. Scrushy out of doing the
15 transaction based on the fact that it was not a
16 good strategic fit. It didn't really fit with the
17 HealthSouth business.

18 Q. Tell us how -- how did you get Mr. McGahan
19 to help you speak with the defendant about this
20 transaction?

21 A. We were continuing to negotiate with
22 Mr. Ormand. And our price -- our stock price had
23 gone down, and their stock price had gone up, and
24 it was really not even making good sense in black
25 and white on paper.

06756

1 But Mr. Scrushy wanted to talk to me
2 about it. I got a call from Mr. Scrushy. He was
3 at his lake house, and he told me that he wanted
4 McGahan and I to come down to his lake house to
5 discuss whether or not we should do this.

6 Q. Did you and Mr. McGahan travel down to the
7 defendant's lake house?

8 A. Yes.

9 Q. Do you recall where his lake house is
10 located?

11 A. It's at Lake Martin.

12 Q. Do you recall when you and Mr. McGahan
13 traveled to Mr. Scrushy's lake house to talk with
14 him?

15 A. It was sometime in early June of 1999.

16 Q. Tell us how you and Mr. McGahan travel down
17 to meet with Mr. Scrushy?

18 A. Mr. McGahan was in New York that morning
19 when I got the call from Mr. Scrushy telling us to
20 come down and see him. So I met Mr. McGahan at
21 the airport, and then we took one of HealthSouth's
22 planes down to Lake Martin.

23 Q. Did you have any conversation with
24 Mr. McGahan while you were traveling from
25 Birmingham down to Lake Martin?

06757

1 A. Yes. I told Mr. McGahan that he had to
2 help me talk Mr. Scrushy out of this, because we
3 were not making our numbers. We were missing our
4 numbers by over three hundred million dollars at
5 that point or more. And I told him that, if we
6 did this transaction, that we would all go to
7 jail.

8 Q. Did you and Mr. McGahan meet with the
9 defendant to talk about the proposed merger with
10 Manorcare?

11 A. Yes, sir, we did.

12 Q. Was there a conversation between you and
13 the defendant with Mr. McGahan being present?

14 A. Yes. And the conversation with Mr. McGahan
15 being present centered around the strategic issues
16 with the merger. Mr. McGahan was not about to
17 bring up the fraud with Mr. Scrushy.

18 MR. LEACH: Objection, Your Honor.

19 THE COURT: Sustained.

20 Q. Just tell us what you told the defendant
21 while Mr. McGahan was present and what the
22 defendant said to you during that conversation.

23 A. I told the defendant I didn't think we
24 needed to do the transaction based on the fact
25 that we would be getting back into the nursing

06758

1 home business, and I didn't think it was a good

2 strategic move for HealthSouth.

3 Q. What, if anything, did the defendant say

4 back to you, if you recall?

5 A. When Mr. McGahan was present or --

6 Q. While he was present first.

7 A. He continued to think it was a good

8 transaction, and he was continuing to want to go

9 forward with it.

10 Q. Did there come a time when Mr. McGahan left

11 the conversation?

12 A. Yes.

13 Q. Did you and Mr. Scrushy have additional

14 conversation without Mr. McGahan being present?

15 A. We did.

16 Q. Can you please tell us what you said and

17 what the defendant said when Mr. McGahan was not

18 present?

19 A. I told Mr. Scrushy that if we go through

20 with this transaction, that the fraud would be

21 exposed. And I said the "fraud" (indicating).

22 Never before had I used that word "fraud."

23 And Mr. Scrushy, at that point, realized

24 that we didn't need to do it if I felt like --

25 MR. LEACH: Objection to realized, Your

06759

1 Honor.

2 THE COURT: Sustained.

3 Q. After you told Mr. Scrushy that the fraud
4 would be exposed, did you all proceed with the
5 transaction?

6 A. No, sir.

7 Q. Did the defendant ask you any questions
8 after you told him that the fraud would be exposed
9 and the deal was not going to take place?

10 A. Mr. Scrushy, because of the fact that
11 McGahan was nearby, said, did you tell Bill, Bill
12 McGahan? And I said, yeah, I told him, but he
13 won't tell anybody because he has as much to lose
14 as we do.

15 Q. What were you talking about when you said
16 yeah, I told Mr. McGahan, but he won't say
17 anything?

18 A. I was talking about the fraud.

19 Q. Was there another alternative on the table
20 at the same time while you were considering
21 Manorcare? Was HealthSouth considering doing
22 anything else?

23 A. Yes, sir. We had left on the table the
24 alternative to split the company into two pieces
25 that we were looking at back in 1998.

06817

1 IN THE UNITED STATES DISTRICT COURT
2 FOR THE NORTHERN DISTRICT OF ALABAMA
3 SOUTHERN DIVISION

4 UNITED STATES OF
5 AMERICA,

6 CR-03-BE-530-S

7 v. Birmingham, Alabama

8 March 4, 2005

9 RICHARD M. SCRUSHY,

10 Defendant.

11 *****

12 TRANSCRIPT OF TRIAL
13 BEFORE THE HONORABLE KARON O. BOWDRE
14 UNITED STATES DISTRICT JUDGE, and jury.

15 VOLUME XXV
16
17
18
19
20
21
22
23
24
25

07024

1 A. I don't recall saying that.

2 Q. Do you ever recall on the same date and
3 time, the same FBI agent admitting that, in fact,
4 you had advised that McGahan knew that the numbers
5 were inflated?

6 A. No, I don't remember that.

7 Q. Do you ever recall having a conversation
8 with Mr. McGahan concerning cooking the books at
9 HealthSouth?

10 A. You are asking me my recollection of what I
11 just said?

12 Q. I'm asking you at any time --

13 A. I had a conversation --

14 Q. -- did you have a conversation with Bill
15 McGahan about cooking the books at HealthSouth.

16 A. I had a conversation with Bill McGahan that
17 we had a three hundred million dollar problem some
18 time in the summer of 1999.

19 Q. During that conversation, did you refer to
20 it as cooking the books?

21 A. No, sir.

22 Q. Did you tell the FBI agents on 10-9-03 and
23 2-9-04 Mr. McGahan knew of and used cooking the
24 books, quote/unquote?

25 A. I can't tell you what was written in an FBI

07025

1 report. I didn't write that report. I haven't

2 reviewed it.

3 Q. Did you ever tell them that?

4 A. I told them what I just told you.

5 Q. Did you ever have any conversations with

6 Mr. McGahan about waiting until the statute of

7 limitations had past on your case?

8 A. Yes, sir, I did.

9 Q. And when did that occur the first time?

10 A. It was after I left the company.

11 Q. When was it?

12 A. I'm thinking. It was probably, the first

13 conversation I had with him regarding that was in

14 2000.

15 Q. Okay.

16 A. Subsequently, virtually every quarter when

17 HealthSouth would get one more quarter out, he

18 would tell me, I have got one more quarter under

19 my belt to get out of the statute of limitations,

20 if fraud was ever discovered.

21 Q. Okay.

22 A. And the irony of it is I didn't understand

23 the law and how far reaching it was and it didn't

24 matter.

25 Q. So when he used the term, and you talked to

07026

1 him about the term statute of limitation, what

2 does that mean?

3 A. What does statute of limitations mean?

4 Q. Yes.

5 A. I'm not a lawyer, but my --

6 Q. You talked to Mr. --

7 A. My impression at that time was the time

8 that had past between when I left HealthSouth and

9 when -- if HealthSouth was ever discovered of

10 committing fraud.

11 But my lack of legal knowledge, which

12 is still severely lacking, is if you leave a

13 conspiracy and you don't come down here and turn

14 yourself in, you don't leave the conspiracy. So I

15 had never left the fraud. I quit the company, and

16 I am still, even though I am thinking they are

17 going to be on solid ground, I am committing fraud

18 just as much as they are and I am not even there.

19 Q. Are you through with your answer?

20 A. Yes, sir.

21 Q. Talking to Mr. McGahan, what were you

22 talking about with him when y'all talked about the

23 statute of limitations passing?

24 MR. SMITH: Objection, asked and

25 answered, Your Honor.

07027

1 THE COURT: Overruled.

2 Q. Thank you, Your Honor.

3 A. I was talking about what I had told him in

4 1999. And in 1999, I told him that we had a three

5 hundred million dollar problem that we were

6 dealing with on our books.

7 Q. Now, you said Mr. McGahan was never

8 involved in the conspiracy; is that correct?

9 A. I think I said Mr. McGahan did not

10 participate in the conspiracy.

11 Q. Do you consider giving advice to someone in

12 a conspiracy about how to do it, being a member of

13 a conspiracy?

14 A. I am not in a position to give that kind of

15 opinion.

16 Q. Did Mr. McGahan ever give you advice about

17 how to handle the conspiracy and the cover up of

18 the fraud?

19 A. No, sir.

20 Q. Never?

21 A. No, sir.

22 Q. Can you tell me on 10-9-03, did you have a

23 conversation with the FBI agents at which time you

24 told them that Bill McGahan had told you to,

25 quote/unquote, bake the earnings for several

07028

1 quarters, unquote?

2 A. That's correct.

3 Q. What does it mean to bake the earnings for
4 several quarters?

5 A. We were using aggressive, my opinion is we
6 were using aggressive acquisition accounting to
7 inflate earnings.

8 Q. So aggressive accounting, though, is not
9 fraud, right?

10 A. At that stage of the game, I didn't think
11 so.

12 Q. Okay.

13 A. When I did it.

14 Q. Right. You thought it was just aggressive
15 accounting?

16 A. Right.

17 Q. You are not an accountant?

18 A. That's right.

19 Q. When Mr. McGahan talked about simply baking
20 the earnings for several quarters, he simply is
21 meaning what now, when y'all are discussing it,
22 what do you need to do to be just aggressive? How
23 do you do the numbers?

24 A. I'm not sure what your question is.

25 Q. Y'all are talking and you admit that he

07029

1 tells you to bake the earnings for several

2 quarters and you thought it was just aggressive

3 accounting.

4 A. I don't -- sir, I don't know what you are

5 reading. Are you asking me a question?

6 Q. Yes.

7 A. What is the question?

8 Q. The question is, did you tell an FBI agent

9 McGahan told you to bake the earnings and you said

10 yes, correct?

11 A. Right.

12 Q. And then I asked you to tell me what it

13 meant by baking the earnings and you said it was

14 simply using aggressive accounting.

15 A. That's right.

16 Q. Okay.

17 A. Okay.

18 Q. So tell me how you do it.

19 MR. SMITH: Time frame.

20 Q. When he told him about baking the numbers,

21 how did you bake the numbers that was aggressive

22 accounting, in what areas?

23 MR. SMITH: Time frame when this

24 happened, Your Honor.

25 THE COURT: Give us a time period.

07038

1 Q. What is the tree in your example?

2 A. Doing that transaction is the tree.

3 Q. Is the tree?

4 A. That's right.

5 Q. So, according to chipping away at the tree,
6 the chipping away came from getting Mr. McGahan to
7 talk to Richard Scrushy about it being simply bad
8 business to go in and do the merger, that is the
9 chipping away, correct?

10 A. I wouldn't characterize it as bad business,
11 per se. I would characterize it as not meeting
12 with our strategic goals.

13 Q. Being legitimate?

14 A. I'm not saying legitimate or illegitimate.

15 Q. What are you saying?

16 A. I am just saying that it wasn't the type of
17 business that HealthSouth needed to be getting
18 into, just after we had sold for a billion two a
19 number of facilities just like what we were
20 talking about merging with.

21 Q. But you remember in your conversation with
22 Mr. McGahan on the ride out, you said, look, we
23 are three hundred million short, right?

24 A. At least three hundred million short.

25 Q. Okay. Not four hundred million?

07039

1 A. I could have said three to four hundred.

2 The truth of the matter, it was probably three to

3 five hundred million.

4 Q. So you tell Mr. McGahan, we are three to

5 five hundred million dollars short, he now knows

6 about the fraud?

7 A. He has knowledge of the fraud.

8 Q. And then you tell him, I want you to talk

9 Richard Scrushy out of this, the merger?

10 A. Again, I asked him to explain the reasons

11 it didn't make strategic sense for HealthSouth to

12 go into that business.

13 Q. Now, tell me the strategic reasons, what

14 they are?

15 A. There weren't any.

16 Q. How was he going to explain strategic

17 reasons if there weren't any?

18 A. It was not a strategic -- there were no

19 strategic reasons.

20 Q. How was Mr. McGahan going to talk to

21 Richard Scrushy at the lake house about strategic

22 reasons if there weren't any?

23 A. He was going to explain to him there were

24 no strategic reasons for us to get into this

25 business because we had just unloaded one point

07042

1 again to make sure I understand it.

2 Q. Let's go back through it because I want to

3 make sure that we are correct here.

4 A. Yes, sir. I want to be very careful.

5 Q. Got it. I want you to, too.

6 A. Thank you.

7 Q. You told us, did you not, that you

8 instructed Mr. McGahan that when he talked to

9 Richard Scrushy at the lake house to give him

10 legitimate business reasons why not to go ahead

11 with this merger?

12 A. Correct.

13 Q. Did you also tell Mr. McGahan that there is

14 fraud and we cannot go further with this deal,

15 this merger, because due diligence or whatever is

16 going to reveal it?

17 A. Yes, sir.

18 Q. Did you tell Mr. McGahan at that time that

19 if the fraud is revealed through this merger, we

20 are all going to go to jail?

21 A. Yes, sir, I believe we did.

22 Q. So, did you tell Mr. McGahan at that time

23 when we get to the lake, do not tell Mr. Scrushy

24 about any of the fraudulent things that could send

25 us to jail, only talk to him about the legitimate